Conservation Easements Might Hide Tax Shelters, IRS Finds

by William Hoffman

The IRS has identified dozens of charitable conservation easement transactions that may be tax shelters, the agency told Senate Finance Committee leadership in a July 13 letter.

As of June 1 the IRS had processed 104 of 200 Forms 8886, “Reportable Transaction Disclosure Statement,” required under Notice 2017-10, 2017-4 IRB 544, according to the letter signed by IRS Commissioner John Koskinen. Of the 104 transactions processed that reported the amounts of both the investment and the claimed charitable contribution, 40 asserted an aggregated total of $217 million in contribution deductions, for an average 9-1 ratio of claimed deductions to investment costs, the letter states. The IRS considers a ratio above 2.5-1 for those transactions to possibly indicate a tax shelter transaction.

The IRS is still receiving filings from transaction participants whose reporting deadline was extended from May 1 to October 2 in Notice 2017-29, 2017-20 IRB 1243, and expects to update Congress with its findings, Koskinen wrote. “Once we compile and analyze all the information from the disclosures, we intend to identify the syndicated transactions that pose the most compliance risk and refer them for examination,” he wrote.

The calculations came in the IRS response to a March 29 request from Finance Committee ranking minority member Ron Wyden, D-Ore., and seconded by Finance Committee Chair Orrin G. Hatch, R-Utah, in a separate letter July 1. The committee leaders asked the IRS to report data it has collected on syndicated conservation easement participants and transactions since the agency implemented Notice 2017-10, which made disclosure mandatory for those deals made after December 31, 2016.

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“I am stunned at the information in this letter,” said Stephen J. Small, an attorney who was principal author of the first conservation easement regulations when he worked at the IRS Office of Chief Counsel from 1978 to 1982. “To me, this just validates the issue . . . that after [the IRS] figures — assuming they’re accurate — the [Brookings Institution’s] figures didn’t tell the entire story,” he said.

Small was referring to a Brookings Institution report, “Charitable Contributions of Conservation Easements,” which found $3.2 billion in conservation easement deductions claimed in 2014 — more than three times the amount claimed in 2012. After seeing the IRS letter, Small said he wouldn’t be surprised if the IRS’s preliminary figures “were just a small fraction of the total number of [syndicated] investors and investments.”

‘Who Can Be Against Them?’

The IRS letter was dated the same day that the House Appropriations Committee voted to recommend a budget bill for Treasury that would take away the tax agency’s power to identify syndicated conservation easement transactions’ participants under Notice 2017-10.

Notice 2017-10, issued December 23, 2016, stated that the IRS would challenge the “purported tax benefits” of syndicated conservation easements and substantially similar transactions “based on the overvaluation of the conservation easement.” The IRS said it might also challenge the transactions’ tax benefits based on the partnership antiabuse rule, economic substance doctrine, or other means.

However, section 114 of the financial services and general government budget bill states: “None of the funds made available by this Act may be used by the Internal Revenue Service to implement or enforce Internal Revenue Service Notice 2017-10 with respect to transactions entered into before January 23, 2017.” Those members of Congress who advocated for or inserted the provision into the budget bill could not be determined.

“I think the pushback is in part because [the IRS] is asking taxpayers to ‘raise their hand’ to alert the IRS to transactions they’ve made over the last couple years,” said Adam Looney, a senior fellow at the Brookings Institution and author of the May 2017 conservation easements report that identified real estate syndicators as potential...
tax frauds. Tax Analysts spoke with Looney before obtaining the IRS letter.

“And I think [syndicators] have a lot of support from their senators and congressmen, and we’re talking hundreds of millions of dollars at stake,” Looney said. “So they are applying a lot of pressure and have hired really good lawyers and lobbyists . . . and since it’s all for ‘conservation,’ who can be against them?”

But Notice 2017-10 has its defenders. “We are extremely supportive of the IRS ruling on 2017-10,” said Tom Cors, the Nature Conservancy’s director of U.S. government relations for lands. The Nature Conservancy claims more than 100 million acres conserved in 72 countries. The IRS’s method of using “extraordinary financial returns,” above the 2.5-1 ratio, “is a very reasonable approach to ferreting out abuse,” he said.

Tucker Clare Nelson, government communications manager for Ducks Unlimited, which operates the Wetlands America Trust, said her volunteer-based nonprofit supports Notice 2017-10 “as a way to ensure conservation easement donation transactions meet both the letter and spirit of the law. . . . Confidence in the integrity of the tax incentives is vital to encourage landowners to voluntarily protect these lands and resources.”

Other stakeholders punt on the issue. Stephen Thor Johnson, president of the North American Land Trust, said his group “believes that it is up to Congress to determine how to direct the IRS to ensure efficient implementation of the law which Congress passed providing enhanced tax incentives for gifts of conservation easements.” He said the trust does not plan to lobby on the matter.

Wyden did not respond to a request for comment on the IRS letter or on the House attempt to forestall IRS monitoring of syndicated conservation easement transactions and participants. Hatch said in a statement that he “is concerned with both possible IRS overreach and any potential tax shelter activity related to syndicated conservation easements.”

‘Clearly Turning Over a Rock’

“Abuse is getting worse,” said Looney, whose report relied primarily on IRS, Treasury Office of Tax Analysis, and Land Trust Alliance data. “A relatively small group of people is using [conservation easements] more intensely,” he said. “They don’t want the IRS to stop their party.”

The problem for tax enforcement arises in distinguishing conservation easement transactions that are legitimate from those that are tax shelters, Looney said and others agreed. “To the IRS, they look almost identical,” he said.

The Land Trust Alliance, which represents more than 1,000 conservation trusts and 5 million members worldwide, supports Notice 2017-10 “because it basically leaves alone the good transactions,” said Wendy Jackson, the alliance’s executive vice president.

“We’ve been worried about these [syndicated] transactions for a very, very long time, and we believe that they defy common sense,” Jackson said. She said it’s almost impossible to profile the syndicators or their transactions in advance: “We just know the deals are happening.” The IRS letter appears to offer proof of that. “It’s clearly turning over a rock,” Small said of the letter.

“It is clear that in these instances, the deductions significantly exceeded the limit established by the IRS,” Jackson said after reviewing the document. “These rates of return are something most taxpayers will never see in their lifetimes.”

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Russell Shay, an independent tax and natural resources consultant to the Land Trust Alliance, was surprised when shown the IRS letter. “It looks like a handful of people bought $200 million in tax deductions for about $20 million and that that’s just the tip of the iceberg. Any tax incentive can be abused, and it sure looks like a few bad actors have gone to town on this one.”

Cors and Jackson said their organizations are making clear to the taxwriting committees how they feel about section 114, “which is basically a ‘Get Out of Jail Free’ card” for suspect conservation deductions, Cors said. “Undoing the notice at this stage would both inflict harm to taxpayers and set back the very reasonable efforts
the IRS has taken to control the situation,” Jackson added.

Section 114’s future in the Senate is uncertain, Jackson and Shay agreed. “It’s great to see that Sens. Hatch and Wyden are working together on this and have asked for more information,” Shay said. “Thanks to the notice, the IRS now knows where to look — it’d be a shame if they didn’t get the chance.”

Shay acknowledged Hatch’s concerns about IRS regulatory overreach. “Conservationists share both of the concerns expressed by Chairman Hatch,” he said. “The IRS has gone after good donations, sometimes in ways that seem to make no sense.”

“But as a guy who gets a $100 tax deduction when I write a $100 check to a charity, I would certainly hope the IRS would look into a circumstance where somebody wrote a $100 check and got a $900 tax deduction for it,” Shay added.